DRAFT

March 28, 1940

Honorable Henry B. Steagall, Chairman,
Banking and Currency Committee,
House of Representatives,
Washington, D. C.

Dear Mr. Chairman:

Reference is made to two bills, H. R. 8638 and S. 1318, generally known as the Steagall bill and the Byrnes bill, which have been referred to your Committee. If your Committee contemplates taking action on either of these bills during the present session of Congress, the Board wishes to be given an opportunity to present its views on the subject.

It is the Board's opinion that no banking legislation of a controversial nature should be undertaken without a previous comprehensive review of the entire field of banking and monetary problems as they exist today. In its Annual Report for 1938 the Board attempted to outline these problems and to point out their inter-relationship. The present banking problems are rooted in the past and are to a considerable extent the outcome of piecemeal legislation enacted to meet specific situations and emergencies over the past 75 years, without any comprehensive plan made with reference to the country's banking needs taken as a whole. It would seem to the Board highly undesirable to proceed further on this path of piecemeal legislation, and it strongly urges that before additional legislation is adopted a rounded program of desirable monetary and banking changes be formulated. The Senate of the United States has adopted a resolution for the purpose of undertaking such a review and the Board respectfully urges the House Banking and Currency Committee to follow a similar course of action either jointly with the Senate Committee or as an independent undertaking by the House Committee.

Without at this time expressing its views thereon, the Board also wishes to point out briefly certain controversial features contained in the two bills under discussion.

The Steagall bill

The Steagall bill raises at least three important questions which are controversial in character and which have an important bearing on fundamental questions in the Government's banking policy.

1. The proposal to remove the Comptroller of the Currency from the board of directors of the Federal Deposit Insurance Corporation opens up the entire question of what steps, if any, should be taken to

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reorganize the existing Federal bank supervisory agencies. The need for such a reorganization was pointed out in the Board's 25th Annual Report and in reports recently released by the Attorney General's Committee on Administrative Procedure. Would it not be better before making changes in existing arrangements to work out a general policy with regard to the relationship between all the Governmental banking agencies and the distribution of duties among them?

2. The reduction of the assessment rate from 1/12 to 1/14 per cent of deposit liabilities raises at least two important questions: (1) What would constitute an adequate assessment for deposit insurance over the long range? (2) What is the proper basis of assessment? If it should be determined that a smaller aggregate income for the Federal Deposit Insurance Corporation would be adequate, the question would still remain whether the best way to reduce the total assessment would be to reduce the rate or to change the assessment base. For example, the opinion is held by many that cash in the banks' vaults and their deposits with the Federal Reserve banks should be eliminated from the basis of assessment, since they do not involve any risk to depositors or to the Federal Deposit Insurance Corporation. It would seem that the question of the rate and the basis of assessment, with their collateral effects on the banking machinery, should be considered in connection with a general banking review, and it would not seem desirable, prior to such a review, to make a change in the rate of assessment.

3. The proposed increase in the coverage of deposit insurance from accounts up to $5,000 to accounts up to $10,000 raises a broad question of public policy, including the problem whether insurance should cover all deposit liabilities and, if not, what part of the liabilities should be covered. An arbitrary increase from $5,000 to $10,000 taken in and of itself prejudges a subject which calls for thorough-going study.

It would seem clear, therefore, that all the important phases of the Steagall bill are in controversial fields and raise problems of a fundamental character.

<u>The Byrnes bill</u>

The Byrnes bill would eliminate from the basis of assessment for deposit insurance the deposits held by insured banks for other banks. It is apparent that this bill is highly controversial in nature and that it would have important effects on the functioning of our banking and monetary mechanism.

The benefits of the proposed change would inure almost entirely to the larger banks which hold the bulk of deposits for correspondent banks throughout the country. Since a large proportion of the deposits in several of the important financial centers consists of deposits for other banks, the elimination of these deposits from the assessment base would materially reduce the cost of insurance for the banks in these large cities.

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By the same token, the proposal would increase the proportion of the total cost of deposit insurance that falls on the smaller banks. If a reduction in the cost of insurance is justified by the facts, there would seem to be no reason why the benefit of the reduction should go entirely to the banks in financial centers. An increase in the proportion of the insurance cost to be borne by small banks means that, if the total cost should later have to be increased, as may well happen, the actual cost to these banks would go up disproportionately. This raises important questions of equity and public policy.

The small banks in the interior have to pay assessments on the deposits made with them by their customers and they also have to pay interest on a considerable proportion of such deposits. When these banks find no profitable way to use their funds at home, they redeposit some of them with their city correspondents and receive no interest for funds so redeposited. The city banks, on the other hand, receive these deposits without interest cost, since they are not permitted to pay interest on demand deposits, and it is now proposed to exempt them from assessments on correspondent bank balances. It is certainly a controversial question whether the proposal is in accordance with equity and in the public interest.

It has been argued that the proposal is justified on the ground that it eliminates duplicate assessments. This argument does not seem to be valid since the Federal Deposit Insurance Corporation would have to pay the depositors of the city bank if it should fail as well as the deposits of the country bank in case it were closed. There are two separate risks and, therefore, every reason for separate assessments.

The proposal in the bill would also have far-reaching effects on the distribution of idle funds throughout the country. It would have the tendency to encourage further concentration of funds in the financial centers, which appears to be contrary to public policy and to the purposes of the Federal Reserve Act and of the Banking Act of 1933. The latter prohibited the payment of interest on demand deposits, largely for the express purpose of discouraging the concentration of balances in financial centers.

Since the Board considers the two proposed bills as having a definite bearing on many broad problems of banking and monetary policy, the Board believes that they should not be considered independently of a comprehensive review of all these problems.

Very truly yours,

Chester Morrill,
Secretary.

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